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Message Text

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FM AMEMBASSY MANILA
TO SECSTATE WASHDC 6727
INFO AMEMBASSY JAKARTA

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C O R R E C T E D C O P Y (TEXT)

USADB

FOR NAC AGENCIES

EO 11652:N/A
TAGS: EAID, EFIN, ADB
SUBJECT: ADB PROPOSED LOAN FOR SECOND POWER DISTRIBUTION
PROJECT - INDONESIA

SUMMARY: ADB MANAGEMENT PROPOSES 31.4 MILLION DOLLARS EQUIVALENT LOAN FROM ORDINARY CAPITAL RESOURCES TO FINANCE THE FOREX COST OF EQUIPMENT AND MATERIAL FOR ENERGY DISTRIBUTION STRUCTURES IN FOUR ZONES IN WEST JAVA. THE GOVERNMENT IS PROVIDING 13.6 MILLION DOLLARS FOR LOCAL COST FINANCING. THE PROJECT IS A PART OF INDONESIA'S INTEGRATED ENERGY DEVELOPMENT PROGRAM FOR WEST JAVA AND IS DESIGNED TO PROVIDE ELECTRIC POWER TO 54,000 CONSUMERS OR 5 PERCENT OF THE POPULATION IN THE FOUR ZONES. FOREX FINANCING IS PLANNED FOR ENGINEERING SERVICES AS WELL AS EQUIPMENT AND MATERIAL TO REHABILITATE AND EXPAND THE
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EXISTING ELECTRIC POWER NETWORK. THE PROJECT IS FINANCIALLY SOUND. ITS ECONOMIC BENEFITS WILL BE SHARED BY A BROAD SPECTRUM OF DOMESTIC, COMMERCIAL AND INDUSTRIAL CONSUMERS. PLN, THE EXECUTING AGENCY, IS CAPABLE OF HANDLING THIS LOAN, BUT IT REQUIRES ADDITIONAL TRAINING FOR THE STAFF, A CONTINGENCY THAT IS PLANNED FOR IN THE PROJECT. USADB RECOMMENDS FAVORABLE NAC CONSIDERATION.

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END OF SUMMARY.

1. ADB DOC R42-78 WITH ATTACHMENTS DESCRIBING PROPOSED LOAN WAS POUCHED ADDRESSEES MAY 25. BOARD CONSIDERATION IS SCHEDULED JUNE 15.

2. ADB MANAGEMENT PROPOSES 31.4 MILLION DOLLARS LOAN FROM ORDINARY CAPITAL RESOURCES TO INDONESIA TO FINANCE THE FOREX COSTS FOR THE SECOND POWER DISTRIBUTION PROJECT IN WEST JAVA. PROCEEDS WILL FINANCE FOREX COSTS OF EQUIPMENT, MATERIAL, AND ENGINEERING SERVICES ASSOCIATED WITH THE REHABILITATION AND EXPANSION OF THE PLN ELECTRIC POWER SYSTEM IN FOUR PROVINCES IN WEST JAVA. RROPOSED TERMS ARE 20 YEARS AMORTIZATION INCLUDING 4 YEARS GRACE PERIOD AND 7.70 PERCENT INTEREST P.A. AND A COMMITMENT CHARGE OF .75 PERCENT PER ANNUM. BORROWER IS THE REPUBLIC OF INDONESIA AND EXECUTING AGENCY IS PERUSAHAAN UMUM LESTRIK NEGARA (PLN), THE GOVERNMENT-OWNED POWER AGENCY.

3. TOTAL INSTILLED GENERATION CAPACITY OF PLN, A GOVERNMENT OWNED ENTERPRISE, WAS 1,700 MW AT THE END OF JANUARY 1978. OF THIS, 19 PERCENT WAS HYDRO AND 81 PERCENT THHRMAL. HOWEVER, ITS MAJOR TRANSMISSION NETWORK IS CONFINED TO JAVA, AN ISLAND COVERING ONLY 7 PERCENT OF INDONESIA'S LAND AREA BUT TWO-THIRDS OF ITS POPULATION. OPERATIONS IN THE OTHER ISLANDS ARE PRIMARILY LOCATED
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AROUND ISOLATED LAND CENTERS IN THE IMPORTANT CITIES. ENERGY SALES FOR PLNNGENERATED ENERGY HAVE HAD AN AVERAGE GROWTH RATE OF 11 PERCENT P.A. BETWEEN 1970 AND 1977 WITH SYSTEM LOSSES RANGING ABOUT 25 PERCENT. OVER THE NEXT 6 YEARS AVERAGE GROWTH OF POWER GENERATION IS PROJECTED AT 20 PERCENT P.A. WITH SYSTEM EEERGY LOSSES AT ABOUT 22 PERCENT. THIS IMPLIES A SIGNIFICANT EFFORT ON THE PART OF PLN TO INCREASE ITS GENERATION CAPACITY AND ITS EFFICIENCY. PLN PROJECTS A SIGNIFICANT EXPANSION OF ITS POWER SYSTEM OVER THE NEXT 10 YEARS, ALMOST SIX-FOLD, WITH MAJOR EMPHASIS ON STEAM AND HYDRO SOURCES AND WITH A MODEST GEO-THERMAL ELEMENT AS WELL. DESPITE ITS PLANS, HOWEVER, PER CAPITA POWER CONSUMPTION FROM PLN CAPACITY WAS ONLY 22 KWH IN 1976/77, A VERY LOW RATE COMPARED WITH SOME OF THE OTHER DEVELOPING COUNNRIES IN THE REGION. THE PROJECT IS LOCATED IN THE WEST JAVA AREA WHERE ONLY SIX PERCENT OF THE POPULATION IS SUPPLIED WITH ELECTRICITY AND IN WHICH ENTERPRISES SUCH AS STEEL, PARTICLE BOARD, MARBLE QUARRY, AND FERTILIZER AS WELL AS MINING AND AGRICULTURE ARE LOCATED. DESPITE THE PREPONDERANCE OF INDUSTRY IN THE AREA, A RECENT SURVEY INDICATES THAT 60 PERCENT OF THE DEMAND FOR ENERGY IS IN THE DOMESTIC AND

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COMMERCIAL SECTORS AND 40 PERCENT IN THE INDUSTRIAL
SECTOR. THE PROPOSED PROJECT IS AN INTEGRAL PART OF THE
PLANNED GENERATION AND DISTRIBUTION SYSTEM IN THE AREA.

4. THE PROPOSED PROJECT PROVIDES FOR REHABILITATION AND
EXPANSION OF THE PRIMARY AND SECONDARY DISTRIBUTION
NETWORK IN THE WESTERN PART OF JAVA. IT INCLUDES
CHANGING THE EXISTING 200/115 VOLT NETWORK TO THE
STANDARD 380/220 VOLTS, MINOR ADDITIONS TO THE 70 KV
TRANSMISSION LINES AND SUBSTATIONS AND SERVICE CONNECTIONS
TO ABOUT 54,000 NEW CONSUMERS. THE PROJECT ALSO INCLUDES
TRAINING PLN PERSONNEL AND PROVISION OF ENGINEERING
CONSULTANCY SERVICES FOR PREPARATION OF DETAILED DESIGNS
AND BID DOCUMENTS AND ASSISTANCE TO PLN IN CONSTRUCTION
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SUPERVISION. THE PROPOSAL IS AN INTEGRAL PART OF PLN'S

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DEVELOPMENT PLAN FOR WEST JAVA AND COMPLIMENTS THE CURRENT
EXPANSION PROGRAM FOR GENERATION AND TRANSMISSION

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FACILITIES IN THE REGION. IT PROVIDES DISTRIBUTION FACILITIES IN FOUR OF THE 11 ZONES IN WEST JAVA, WITH THE OTHER 7 ZONES BEING COVERED BY A PRIOR ADB LOAN, IBRD LOAN AND WITH ASSISTANCE FROM KUWAIT AND ABU DHABI FUND. AN ADDITIONAL 54,000 CONSUMERS WILL BENEFIT DIRECTLY FROM THE PROJECT OR 5 PERCENT OF THE POPULATION IN THE FOUR ZONES IN WHICH THE PROJECT WILL BE LOCATED. THE AREAS DESIGNATE FOR ELECTRIFICATION ARE LOCATED ADJACENT TO EXISTING AREAS ALREADY ELECTRIFIED OR TO THE NEW SUBSTATIONS TO BE CONSTRUCTED AS PART OF THE OVERALL POWER DEVELOPMENT PLAN OF PLN. IN THIS RESPECT THE POWER PROJECT IS TECHNICALLY WELL CONCEIVED AND A REVERSAL OF PAST PRACTICES OF RESPONDING TO DEMANDS FOR ELECTRIFICATION WITH AD HOC LOW CAPACITY OVERHEAD LINES FROM ANY CONVENIENT POWER SOURCE. FURTHERMORE, IN VIEW OF THE EVOLVING NATURE OF THE LARGE THERMAL AND HYDRO STATIONS LOCATED AT ECONOMICALLY VIABLE
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SITES AND THE CONCOMITANT WELL-PLANNED HIGH VOLTAGE NETWORK WHICH ARE DESIGNED TO SERVE JAVA IN THE 1980S, THE PROJECT IS CONSIDERED THE BEST TECHNICAL ALTERNATIVE.

5. TOTAL COST OF THE PROJECT IS ESTIMATED AT 45.0 MILLION DOLLARS OF WHICH 31.4 MILLION DOLLARS IS IN FOREX AND 13.6 MILLION DOLLARS IN LOCAL CURRENCY. FOREX COSTS ARE PRIMARILY FOR EQUIPMENT AND MATERIAL FOR CONNECTIONS TO CONSUMERS, DISTRIBUTION LINES, AND SUBSTATIONS AND 20 KV LINES AND SWITCHING STATIONS. ALSO, ABOUT 1.1 MILLION DOLLARS IS ESTIMATED FOR ENGINEERING SERVICES. THE COST OF IMPORTED EQUIPMENT AND SERVICES WHICH ARE TO BE PROCURED BY INTERNATIONAL COMPETITIVE BIDDING ARE BASED ON QUOTATIONS RECEIVED BY PLN IN LATE 1977 IN RESPONSE TO INTERNATIONAL TENDER INVITATIONS FOR SIMILAR EQUIPMENT, AND UPDATED IN MID-1978. PROCUREMENT OF GOODS TO BE FINANCED FROM THE LOAN WILL BE IN ACCORDANCE WITH BANK'S GUIDELINES FOR PROCUREMENT. EACH CONTRACT ESTIMATED TO COST 100,000 DOLLARS OR MORE WILL BE AWARDED ON THE BASIS OF INTERNATIONAL COMPETITIVE BIDDING. CONSULTANTS WILL BE REQUIRED FOR PREPARATION OF DESIGNS AND TENDER DOCUMENTS AND TO ASSIST THE EXECUTING AGENCY IN PROCUREMENT, COORDINATION AND MONITORING OF CONTRACTS. THEY WILL ALSO BE NEEDED FOR SUPERVISION OF CONSTRUCTION, INSTALLATION AND COMMISSIONING OF THE WORKS, PREPARATION OF COMPLETION RECORDS AND TRAINING OF PLN STAFF. THE BANK'S GUIDELINES ON USES OF CONSULTANTS WOULD BE FOLLOWED IN THE SELECTION OF CONSULTANTS. DETAILS OF THE TERMS OF REFERENCE ARE IN THE APPENDIX OF THE PROJECT APPRAISAL REPORT.

6. PERUSAHAAN UMUM LISTRIK NEGARA (PLN) IS THE EXECUTING AGENCY FOR THE PROPOSED PROJECT. THE GOVERNMENT-OWNED

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ENTERPRISE WAS CREATED IN 1961 AND RESTRUCTURED IN 1972
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WITH EXCLUSIVE RIGHTS FOR GENERATION, TRANSMISSION AND DISTRIBUTION OF ELECTRIC POWER THROUGHOUT INDONESIA. THE MINISTER OF MINES AND ENERGY EXERCISES GENERAL POLICY CONTROL OVER THE AGENCY. HOWEVER, HE IS ADVISED BY A BOARD CONSISTING OF THE MINISTERS OF FINANCE AND INDUSTRY AND THE CHAIRMAN OF THE NATIONAL PLANNING BOARD (BAPPENAS). DESPITE ITS EFFORTS TO TRAIN STAFF, PLN CONTINUES TO SUFFER FROM A SHORTAGE OF TRAINED MANPOWER RESULTING IN ITS IMPAIRMENT OF EFFICIENCY AS EVIDENCED BY ITS ENERGY LOSSES OF AROUND 25 PERCENT. ITS CURRENT TRAINING PROGRAM INCLUDES SPECIAL COURSES FOR FINANCE AND ADMINISTRATION PERSONNEL, TECHNICAL TRAINING IN GENERATION, TRANSMISSION AND CONSTRUCTION AND MAINTENANCE OF DISTRIBUTION STRUCTURES, DIESEL PLANT AND DISTRIBUTION MAINTENANCE AND STEAM AND GAS TURBINE PLANT OPERATIONS. THE BANK HAS APPROVED 10 LOANS TO INDONESIA IN THE POWER SECTOR TO DATE. GOVERNMENT'S RECORD OF IMPLEMENTATION HAS NOT BEEN VERY GOOD. NINE OF THE 10 PROJECTS, FOR EXAMPLE, HAVE EXPERIENCED DELAYS IN COMMENCEMENT OF PROCUREMENT ACTION FROM ONE TO FOUR YEARS, COMPLETION OF PROCUREMENT ACTION DELAYS RANGED FROM THREE MONTHS TO THRE YEARS FOR 8 LOANS AND COMPLETION OF CONSTRUCTION WORKS WAS DELAYED FROM ONE TO FIVE YEARS IN NINE LOANS. RECRUITMENT OF CONSULTANTS WAS ALSO DELAYED FROM 6 TO 16 MONTHS AMONG THE 9 PROJECTS. WHILE PLN'S COMPLIANCE WITH LOAN COVENANTS IS GENERALLY SATISFACTORY, IT HAS HAD SOME DIFFICULTIES WITH SEVERAL KEY COVENANTS. ITS MOST SERIOUS BREACH OF AGREEMENT TO DATE IS ITS DELAY TO SUBMIT AUDITED ACCOUNTS WITHIN 6 MONTHS AFTER THE CLOSE OF THE YEAR.

7. THE FINANCIAL JUSTIFICATION IS BASED ON PLN'S PROJECTED INSTALLED GENERATION CAPACITY WHICH IS PLANNED TO INCREASE FROM 1005 MW TO 4220 MW BY 1986 WHILE SALES OF ELECTRICITY ARE EXPECTED TO INCREASE FROM ABOUT 2500 GWH TO 13,700 GWH. THE FINANCIAL RATE OF RETURN ON INVESTMENT, THEREFORE, IS ESTIMATED AT ABOUT 12.3 PERCENT,
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A FAVORABLE RETURN WHEN COMPARED WITH THE COST OF CAPITAL WHICH IS ESTIMATED IN THE ORDER OF 10 PERCENT. FOR

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CALCULATING THE FIRR, INVESTMENT IN CONSUMER CONNECTIONS HAVE BEEE EXCLUDED AAS THEY TEND TO BE OFFSET BY CONSUMER CONTRIBUTIONS. HOWEVER, INVESTMENTS IN SUPPORTING SERVICES SUCH AS OFFICE BUILDINGS HAVE BEEN INCLUDED. WORK IN PROCESS FROM 1977-1978 IS DEDUCTED IN ORDER TO INCLUDE ONLY CAPITAL INVESTMENTS DURING THE PERIOD THAT WILL RELATE TO INCREASED GENERATION AND SALES DURING THE PERIOD. ECONOMIC BENEFITS ARE ATTRIBUTABLE TO THE PROVISION OF ELECTRICITY ON A FIRST-TIME BASIS TO ABOUT 54,000 NEW CONSUMERS, AND TO A REDUCTION IN COST OF ELECTRICITY TO INDUSTRIAL AND COMMERCIAL CONSUMERS. IN ORDER TO REACH THE LOWER INCOME CONSUMER, PLN REDUCED ITS CONNECTION CHARGES FROM 300 DOLLARS PER ONE KW OF CONNECTED LOAD FOR DOMESTIC AND COMMERCIAL CONSUMERS TO 180 DOLLARS PER ONE KW. PAYMENTS IN INSTALLMENTS WERE INTRODUCED AS WELL TO HELP LOWER INCOME CONSUMERS. INDUSTRIAL AND COMMERCIAL USERS CURRENTLY PROVIDING THEIR OWN CAPITAL POWER WHICH IS RELATIVELY HIGH COST BECAUSE OF DISECONOMIES IN SMALL-SCALE POWER PLANTS, WILL ALSO BENEFIT FROM THE LOWER COST OF PLN PROVIDED ENERGY. ALL CONSUMERS SHOULD BENEFIT FROM A REDUCTION IN WIDE VOLTAGE FLUCTUATIONS WHICH TEND TO DAMAGE EQUIPMENT AND TO REDUCE
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THEIR USEFUL LIVES. THE BANK'S APPRAISAL TEAM BELIEVES, THEREFORE, THAT THE ECONOMIC JUSTIFICATION OF THE PROJECT

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RESTS ON THE QUALITATIVE BENEFITS THAT WILL ACCRUE TO A BROAD RANGE OF CONSUMERS, THUS ITS INABILITY TO PROVIDE A DEFINITIVE QUANTITATIVE ANALYSIS OF THE ECONOMIC BENEFITS.

8. THE FINANCIAL ASPECTS OF THE PROJECT ARE SATISFACTORY BUT REQUIRE SOME UPGRADING TO PERMIT PLN TO OPERATE EFFICIENTLY. THE NEED FOR UPGRADING ACCOUNTING STAFF IS HIGH PRIORITY FOR PLN AS IS THE NEED TO REVISE AND UPGRADE CURRENT ACCOUNTING PRACTICES RELATED TO INVENTORY CONTROL, BAD DEBTS AND ANALYSIS OF ACCOUNTS RECEIVABLE. THIS ASPECT OF PLN WILL BE REVIEWED BY AN INDEPENDENT PRIVATE AUDITOR WHO WILL UNDERTAKE A MANAGEMENT AUDIT OF PLN IN 1978/79. INTERNAL AUDIT REPORTS NEED TO INCLUDE COMMENTS ON THE ADEQUACY OF FINANCIAL CONTROL PROCEDURES AS WELL AS THE TIMELINESS OF COMPLETION OF THE FINAL AUDIT REPORT. IBRD IS CURRENTLY HELPING PLN REVIEW ITS TARIFF STRUCTURE IN APRIL 1979 BASED ON LONG-RUN MARGINAL COSTS. OVER THE PAST THREE YEARS, PLN'S OPERATING PERFORMANCE IMPROVED WITH SALES VOLUME INCREASING BBY 26 PERCENT AND AVERAGE TARIFFS INCREASING BY 65 PERCENT. DURING THE SAME PERIOD ENERGY LOSSES WERE SLIGHTLY REDUCED FROM 27 PERCENT OF SALES TO 25 PERCENT WHILE OPERATING EXPENSES OTHER THAN FUEL AND DEPRECIATION WERE REDUCED FROM 53 PERCENT OF SALES TO 45 PERCENT. DESPITE AN INCREASE OF FUEL COSTS FROM 20 PERCENT OF SALES TO 626 PERCENT, THE OVERALL RESULT WAS AN INCREASE IN PROFITS FROM NEGATIVE RP 2.2 BILLION TO A PLUS RP 1.0 BILLION. WHILE ITS OVERALL FINANCIAL PERFORMANCE HAS BEEN SATISFACTORY, IT NEEDS SPECIAL ATTENTION IN THE AREAS OF ENERGY LOSSES, PERSONNEL COST INCREASES, AND INVENTORY LOSSES.
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9. USADB COMMENTS: THE PROPOSED PROJECT IS ONE OF A NUMBER OF SIMILAR PROJECTS IN THE WEST JAVA AREA, ALL OF WHICH ARE DESIGNED TO PROVIDE ENERGY TO DOMESTIC, COMMERCIAL AND INDUSTRIAL CONSUMERS. DESPITE HERCULEAN EFFORTS BY A NUMBER OF DONORS IN PROVIDING ELECTRIC POWER TO THE AREA A RELATIVELY SMALL PROPORTION OF THE TOTAL POPULATION IN WEST JAVA IS BENEFITING DIRECTLY FROM ELECTRIFICATION, I.E., ABOUT SIX PERCENT. HAVING SAID THIS, HOWEVER, THE SECONDARY BENEFITS OF ELECTRIC POWER SHOULD NOT BE UNDER ESTIMATED. WHILE THIS ASPECT OF THE PROJECT HAS NOT BEEN APPRAISED, CONVENTIONAL WISDOM IN THE BANK WOULD INDICATE THAT THE ECONOMIC AND SOCIAL BENEFITS OF THE PROPOSED PROJECT ARE CONSIDERABLE. WE REGRET THAT BANK STAFF HAS NOT MADE AN EFFORT TO ASSESS THE POTENTIAL IMPACT OF THIS PROJECT ON THE CONSUMERS OF ELECTRIC ENERGY, PARTICULARLY AS A NUMBER OF SIMILAR PROJECTS HAVE

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BEEN AND ARE BEING IMPLEMENTED IN THE SAME REGION. BANK
STAFF IS AWARE OF THIS DEFICIENCY AND IS QUICK TO
ACKNOWLEDGE IT; HOWEVER, IT ADMITS IT IS AT A LOSS IN
ASSESSING THE POTENTIAL IMPACT OF THE PROJECT BECAUSE OF
THE LACK OF ADEQUATE, AVAILABLE METHODOLOGY FOR ASSESSING
BENEFITS TO CONSUMERS IN URBAN AND SUBURBAN AREAS, AND
THE LACK OF TIME TO MOUNT SUCH AN EFFORT. WE BELIEVE,
HOWEVER, THAT OUR DISCUSSION WITH STAFF ON THIS MATTER,
INCLUDING THE CHIEF OF THE ECONOMIC SECTION, HAS
EFFECTIVELY RAISED THE ISSUE AS A MATTER OF CONCERN TO US.
WE BELIEVE THAT FURTHER REITERATION OF THIS IN THE BOARD
MEETING WILL REINFORCE THIS CONCERN. ADB PROJECT STAFF
HAVE AGREED TO MODIFY THE TERMS OF REFERENCE OF THE
CONSULTANTS TO PERMIT THEM TO GATHER CERTAIN BASELINE DATA
AS WELL AS TO IDENTIFY DATA SERVICES FOR MONITORING
PROGRESS OF THE PROJECT. HAVING SAID THIS, WE BELIEVE
THE PROJECT IS WELL PLANNED AND IS A PART OF A SUBSTANTIAL

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USADB

FOR NAC AGENCIES

SCHEME TO ELECTRIFY THE WEST JAVA AREA IN CONCERT WITH A
HOST OF OTHER SIMILAR ACTIVITIES. USADB SUPPORTS THE
PROJECT AND RECOMMENDS FAVORABLE NAC ACTION.
10. REQUEST AMEMBASSY JAKARTA COMMENTS FOR NAC AGENCIES,
INFO USADB MANILA, PURSUANT TO STATE 119795 DATED
JULY 3, 1972. WE ARE PARTICULARLY INTERESTED IN THE
USAID REACTION IN VIEW OF ITS RECENT RURAL ELECTRIFICATION

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